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# As I See

## THE COMMODITY AND STOCK MARKET BREAK AND THE OUTLOOK FOR REAL ESTATE

THE fact that the values of many commodities have had drastic drops, and that the values of all listed stocks have declined by $6-1/2 billion since last October, does not indicate so much that hard times are immediately ahead, as it does that soft times are about over. Many luxury lines started falling off last year, and the cost of high living, in my opinion, will continue to drop faster than the high cost of living.

Business men generally are now worrying about the possibility that the drop in commodities and stocks may be only the beginning of postwar deflation similar to the drops which occurred in 1920 and 1921. At that time the general price level dropped by 44 per cent in 11 months, agricultural products dropped by 53 per cent in 13 months, and the price of lumber dropped by 59 per cent in 16 months. Unemployment developed and rose to sizable proportions, and business underwent one of the sharpest contractions on record. Inventory losses forced many companies into bankruptcy, and the business failure index rose rapidly.

This sharp depression had only a minor effect on real estate. It is true that real estate activity, which had gotten to about 24 per cent above normal, dropped back in 1921 to 4 per cent below normal, but the drop was short-lived, and by 1922 and 1923 real estate activity was again climbing rapidly. Foreclosures were entirely unaffected by the drop in business, the foreclosure index declining during 1920 and moving sideways during 1921 and 1922. Some effect of this depression is apparent in a study of real estate vacancies. In the spring of 1920 the housing shortage was at its peak, with the type of ads reproduced to the right appearing in the newspapers reminding one of the type of ads we have seen during the past few years. By May of 1922, however, apartments, flats and residences were again being advertised for rent in large numbers, with some advertisements offering special inducements in reduced rents and in offers to redecorate. This easing of the housing shortage was due almost entirely to the shrinkage in demand due to unemployment, as by the beginning of 1922 new building had not yet started up in any quantity. The real building boom started later in the year and reached its peak in 1925 and 1926. In most cities, residential rents continued to climb during the depression of

FLAT Wtd.—$25 bonus; 1 or 2 year lease; hot-water heat; with garage; O'Fallon Park district; bank reference; about $60 per month; 2 in family. Add. A 57, G.-D.

HOUSE Wtd.—5 or 6 rooms; $10 reward; reference furnished. Add. C 71, G.-D.

RESIDENCE Wtd.—6 rooms; modern; West End, between Taylor and Kingshighway; 3 adults; $20 reward. Add. Y 302, G.-D.

FLAT Wtd.—$15 reward for flat, 3 or 4 rooms, West End location, modern. Add. G 840, G.-D.

HOUSE Wtd.—6 or 8 rooms, or small upper and lower flat, by July 1; 6 months' rent in advance. Add. Y 396, G.-D.

FLAT Wtd.—$15 reward to person helping me to get 6-room flat. Add. M 160, G.-D.

FLAT Wtd.—Upper; 1 year; will pay 6 months' rent in advance. Add. R 166, G.-D.

FLAT Wtd.—Family of 4 adults; modern; 6 rooms; South Side preferred; reward. Add. A 74, G.-D.

FLAT OR COTTAGE Wtd.—To rent; 4 or 5 rooms, modern, South Side; $20 to $30 reward. Add. T 83, G.-D.

FLAT Wtd.—$20 reward; 3 or 4 rooms; strictly modern; must be West End location. Add. B 982, G.-D.

FLAT Wtd.—3 rooms, bath, electric, North Side; couple; $15 reward. Add. H 116, G.-D.

1920 and 1921, with the national average reaching its peak in 1925.

In my opinion, the resemblance of the present situation to that of 1920 and 1921 is not too great, and I think there is very little likelihood of a sharp drastic depression developing as rapidly and going as deep as it did then. The first six months of 1948, it seems to me, will be pretty good from the standpoint of industrial production, retail sales and most other indexes used to measure general business activity. There seems no likelihood, insofar as I can see, that lumber prices are about to duplicate the experience of 28 years ago. While I do think there might be some possibility of a 25 to 35 per cent drop in lumber prices in the latter part of 1948 or in 1949, I will be surprised if the drops are greater than this.

Unless unemployment should develop more rapidly than now seems probable, the housing shortage will be with us during all of 1948, but less acute than it has been during the last two years. Brokerage activity will be below the very high levels of 1946 and 1947, but again it seems to me that it will continue considerably above our long-term normal. I think there is little chance that foreclosures will show any pronounced movement during the first six months of 1948.

At the present time, credit has tightened markedly for speculative real estate, with the possibility of financing 100 per cent investments greatly reduced. Four per cent money has practically disappeared from the market, and undoubtedly this tightening of the mortgage situation will have its effect on the volume of new building which would otherwise be done, and on many sales of existing properties which are dependent on refinancing.

I think it entirely probable, however, that a great deal of pressure will be put on the construction industry to develop additional rental projects insured practically 100 per cent by the FHA. It seems to me that a large volume of building will be developed along this line during 1948, and this will offset to a large extent the shrinkage I expect in the building of single-family residences. The almost immediate over-all effect, of course, will be to ease the housing shortage by the number of units constructed. From the standpoint of the mortgage lender, however, I consider these loans unsound, and made palatable only by the government guarantees.

If I were in the brokerage business, I would begin immediately to put my house in order. By this I do not mean that the real estate brokerage business will collapse overnight, as I certainly do not think that it will. I think it probable that the volume of sales will continue somewhere around its present level during this year, and that it will be several years more before real estate sales drop below the long-term computed normal. The very easy money period, however, is over.

I would attempt to trim overhead, which in most concerns has grown rapidly during the period of the seller's market. I would discard inefficient personnel and inefficient methods. I would accept listings only at prices which are in line with the probable prospects for a gradual drop in real estate values. Charts like those in the forecast issue for January 1948 can be used to convince prospective sellers that it is wise to sell and unwise to wait too long for a price which probably can no longer be gotten.

I would endeavor to increase my percentage of profit, realizing that if I didn't,

later on profits might turn into losses. I would not try to maintain a larger sales force than I thought could be justified by a much smaller volume of business in my community than had been obtained during the past few years. I would go very slowly in taking back second mortgages for commissions, unless these mortgages were well secured and paid off rapidly.

If I were in the mortgage business, I should make my loan commitments with great care, particularly on older buildings. Many buildings in blighted areas will undergo a very considerable shrinkage of value during the next seven or eight years; in fact, many totally obsolete residential buildings which are now paying a return on a hypothetical value will probably cost considerably more to maintain and operate by the middle fifties than their gross revenue. The strict enforcement of safety and health provisions during the next period of high vacancy will, in my opinion, force the demolition of thousands of units of this type of housing, with the land remaining after the buildings are razed worth only a small fraction of the present opinion of value of the existing property.

In making 608 loans I would make them with the understanding that I am probably buying government debentures, as I think in many cases this will be the eventual result.

Of course, I realize that there is always the possibility that the sideways movement which I expect during 1948 in most real estate barometers may continue much longer than I now expect. If this be the case, it will enable the makers of many heavy amortized mortgages to get the mortgages down to the point where they can ride through an adverse period. It will also give the owners of a great deal of existing real estate a chance to sell, conserving the profits they have made during the past few years. It should be emphasized again, however, that from the standpoint of investment the present is not the time to buy residential real estate. Any time is a good time to buy a home if one can afford the loss which homes bought at the present time will involve if it becomes necessary to sell them seven or eight years in the future. Homes at the present time should not be bought on slim margins.

I have received many letters in the recent past asking my opinion on large apartment buildings built some years ago, and I have found it quite difficult to answer these questions. I realize, of course, that in most of these buildings, rentals have been frozen below economic levels, and that in a free market net income from these properties would be considerably higher than it is at present.

An examination of selling prices on many of these buildings, however, would indicate that the buildings at the present time are not being valued on the basis of the present net income but that the prospective sellers and buyers are taking into consideration a probable increase in future rents and are exchanging these buildings with a great deal of weight being given to the large increase in replacement cost. Insofar as present prices discount the increased rentals of the future, it might be well to sell the buildings at the present time, as there has generally been a tendency in investments of this sort to over-discount favorable factors in the future. I have generally replied to letters asking my advice that on apartment properties I believed it necessary to study each individual property rather than to generalize on the entire over-all situation. In other words, it seems to me that some apartments are probably still under-priced and some over-priced on today's market.

I am still relatively optimistic on the future of well-located and well-designed office buildings. Present square foot rentals are still too low to warrant new construction, and it seems to me that no great volume of office building space can be built during the next few years. At the present time the demand for office space in most cities exceeds the supply, and it looks very much as if tenants will continue to bid against one another for the limited amount of space available. In some cases, however, buildings have changed hands taking into consideration the outlook for higher rents and the speculative profit has largely gone to the seller. In some cases, however, buildings can still be bought with some speculative advantage to the buyer.

One other factor should be taken into consideration in real estate investments. The increase in interest rates will probably be followed with some lag by a slight strengthening in capitalization rates, which have been extremely weak during the past five to ten years. With a higher interest charge on buildings which must be financed, and a higher capitalization rate on the net income, the value of the equity may be adversely affected.

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